No. 13220

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CARMELO J. PELLEGRINO,

Appellant,

vs.

WILLIAM D. NESBIT, HUGH F. COLVIN, JAMES R. BRADBURN and CONSOLIDATED ENGINEERING CORPORATION,

Appellees.

APPELLANT'S REPLY BRIEF.

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POINT I.

Appellant's Application to the District Court for Leave to Intervene Was Timely and the Court Should Have Granted His Motion as a Matter of Right.

Appellees' remarks in their answering brief (p. 26), which surreptitiously seek to impute improper motives and conduct to both appellant and his attorneys, are only a hastily improvised smoke screen thrown up by them in a desperate effort to divert this Court's attention from the real issues involved and their own untenably weak position.

It is true that appellant first directed the corporation's attention to the individual appellees' violation of Section 16(b) of the Securities Exchange Act of 1934. The true

facts, however, are directly contrary and at variance with the insinuation contained in appellees' brief (p. 26) that appellant's "effort to intervene is nothing more than an attempt to foster litigation and compel the payment of fees to his attorney." Instead of immediately moving to intervene in the suits, as would have been the case if appellees' insinuation had an iota of merit, appellant was content to permit the corporation alone to prosecute the actions to final judgment under the impression that they were being prosecuted diligently.

It was not until *after* the District Court had rendered adverse judgments against the corporation and *after* the refusal of its Board of Directors to appeal therefrom with full knowledge that the opinion in the case decided by the United States Court of Appeals for the Second Circuit in *Steinberg v. Sharpe* (C. A. 2, 1951), 190 F. 2d 82, was directly contrary to the District Court's decision, that appellant, in the exercise of the rights expressly conferred upon him by Section 16(b) of the act, moved to intervene for the purpose of appealing from the judgments because the corporation had failed "diligently to prosecute the same thereafter."

That appellant proceeded with due diligence and his application to intervene was timely there can be no doubt. The judgments were entered by the District Court on October 30, 1951. [R. pp. 91-92, 99-100, 108-109.] It was not until *after* appellant's attorney *received* the "letter *dated* November 15, 1951" [R. p. 114] from the corporation's counsel advising him "the Board of Directors by resolution decided that the Company would not take an appeal in any of the three cases" [R. p. 115], that appellant first learned that the corporation would "fail diligently to prosecute the same thereafter."

This Court will undoubtedly take judicial notice that New York City and Los Angeles are many miles apart and that it takes several days from the date mail is *sent* from one city to be *received* in the other. Appellant's motion for leave to intervene was *argued and heard* before the District Court on November 29, 1951, only fourteen (14) days from the date counsel for the corporation *sent* the letter advising that the Board of Directors refused to appeal from the adverse judgments. It is respectfully submitted that under these circumstances, appellant could hardly have been expected to have acted more timely or diligently than he did.

Apart from the fact that Section 16(b) expressly conferred an absolute license upon appellant as a stockholder of the corporation to make demand upon it to recover the short swing profits realized by appellees herein, and that he had no "ulterior motive" as intimated by appellees, the Supreme Court of the United States has stated in *Young v. Higbee,* 324 U. S. 204, 65 S. Ct. 594, 89 L. Ed. 890, that motive of a stockholder in bringing suit for the benefit of his corporation is wholly immaterial and should be disregarded. Thus the Court said at page 214:

> "Nor can we sustain the contention that relief should be denied on the allegations that Young's motive in bringing the proceeding is an unworthy one. His petition sought relief for the benefit of all the stockholders. The rights of these stockholders are not to be ignored because of some motive attributable to Young."

Appellees attempt to capitalize upon the small interest of appellant in the stock of the corporation. The most appropriate answer to this is a quotation from the opinion

in *Huber v. Martin,* 127 Wisc. 412, 105 N. W. 1031, where the Court said:

> "* * * the corporation itself belongs to the members thereof and any such member, however small his interest, may knock successfully at the judicial doors to prevent the use of the corporate assets in any other way than in strict harmony with what has been said (about use for authorized corporate purposes) * * * The idea that a member of a corporation * * * cannot in behalf of himself and others similarly interested apply successfully at the door of equity because his interest as a single member is small is unworthy to be entertained."

The snide remarks by appellees that this appeal "is but an instrument for the recovery of attorney's fees" can best be answered by quoting from an article written by the late Professor Henry W. Ballentine, California's leading authority on corporation law, in 37 Cal. L. Rev. (September, 1949) 399, at page 413:

> "A shareholder before he volunteers as a plaintiff to champion the cause of his corporation's right of action, must give consideration to the time, trouble and expense of bringing such suit and the loss in which he will be involved if he fails to succeed. Since the incentive which the law holds out to make possible the bringing of derivative suits is not any compensation to the plaintiff himself, but a counsel fee to the plaintiff's attorney, it may be desirable not to discourage competent lawyers from instigating shareholders' suits if the suit can be prosecuted and settled only under proper regulation. A liberal allowance of counsel fee is made to plaintiff's counsel according to the benefits secured, as this is the dynamic factor giving the necessary impetus to the

volunteer method of representation in class and derivative suits. Otherwise no shareholder could possibly afford to begin a suit of such size and extreme difficulty with only a comparatively small individual interest in it."

It appears singularly significant from the actions of the appellees in so vigorously opposing appellant's intervention that they fear a diligent prosecution of an appeal.

The individual appellees have attempted to point out in their brief (p. 8) that since their combined stockholdings in the corporation "never exceeded a fraction over 3% of the outstanding stock of the plaintiff corporation" they should not be deemed to have been dominant in the affairs of the corporation, and that the precedent set up by the United States Court of Appeals in the case of *Park & Tilford, Inc. v. Schulte* (C. A. 2, 1947), 160 F. 2d 984, cert. den., 332 U. S. 761, 68 S. Ct. 64, 92 L. Ed. 347, which reversed the District Court and permitted a stockholder of the corporation to intervene in the suit, should not be made applicable to them. Appellees glibly attempt to overlook the realities actually existing in corporations having numerous stockholders scattered all over the world and individually owning only minute percentages of stock therein. A small group of stockholders like appellees owning "a fraction over 3%" can easily dominate and control the corporation.

It is to guard against even such *likelihood* of domination that Section 16(b) made provision that a stockholder could bring suit on behalf of the corporation if it "should fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter."

It is respectfully submitted that the refusal of the corporation to prosecute an appeal from the judgments was tantamount to its failure "diligently to prosecute the same thereafter" and conferred an absolute right upon appellant to be permitted to intervene for the purpose of appealing from the District Court's judgments.

POINT II.

This Court Has the Power to Review the District Court's Judgments Upon the Record Before It.

It is respectfully submitted that should this Court reverse the District Court's judgment which denied appellant's application to intervene, then it has the power on the record before it to treat appellant's appeal as though it were an appeal on the merits from the judgments entered below. (See *Park & Tilford, Inc. v. Schulte, supra.*)

In the Court below the actions against the individual appellees were "submitted for final decision by agreement of the parties upon the question of liability only, all matters with regard to damages and the measure thereof having been reserved for further proceedings." [R. pp. 85, 93-94, 102.]

The District Court made certain Findings of Fact which is conceded by appellant herein with the exception of one paragraph thereof (proper only as a conclusion of law) which states that "Plaintiff, by its actions herein, is estopped from recovering profits, if any, from the transactions of defendant in the stock of plaintiff under said option agreement which plaintiff initiated and set up and which plaintiff, at least inferentially, assured defendant to be valid." [R. pp. 89, 97-98, 106.]

The sole issue before this Court, therefore, is whether the District Court's Findings of Fact, the truth of which is conceded by appellant with the exception noted above, all of which are included in the record before this Court, entitled the individual appellees to judgments as a matter of law.

The individual appellees have fully argued this point in their brief and this Court can, therefore, properly review the judgments of the District Court.

POINT III.

Estoppel or Waiver Is Unavailable as a Defense to Appellees Under Section 16(b) of the Securities Exchange Act of 1934.

The Securities Exchange Act of 1934 was specifically enacted by Congress after protracted hearings for the protection of the public interest.

It has been held again and again both by the Courts and legal scholars that neither estoppel nor waiver is available as a defense to a statute enacted for the protection of a public interest.

In *Scott Paper Co. v. Marcalus Mfg. Co.,* 326 U. S. 249, 66 S. Ct. 101, 90 L. Ed. 47, rehearing denied, 326 U. S. 811, 66 S. Ct. 263, 90 L. Ed. 495, the Court said (p. 257):

> "* * * For no more than private contract can estoppel be the means of successfully avoiding the requirements of legislation enacted for the protection of a public interest. * * *"

Appellant's opening brief has fully set forth other cases to the same effect. The brief submitted by the Securities

and Exchange Commission persuasively argues this point and concurs in it.

Stripped of this equitable defense the District Court apparently found that "The hard rule of law might indicate that judgment should be rendered in favor of plaintiffs." [R. p. 83.]

It is respectfully submitted that the judgments of the court below should be reversed.

Conclusion.

The judgment of the District Court denying appellant's motion to intervene should be reversed and the judgments entered in the court below in favor of the individual appellees should be reversed on the merits.

Respectfully submitted,

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